

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF CHRIS HANI DISTRICT MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2009

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of Chris Hani District Municipality which comprise the statement of financial position as at 30 June 2009, the statement of financial performance, the statement of changes in net assets, the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Statements of Generally Recognised Accounting Practice (GRAP) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3)(d) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit. Because of the matter(s) described in the Basis for disclaimer of opinion paragraph(s), however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Other debtors

4. The corresponding figure for other debtors did not reconcile to the prior year audited financial statements as it increased by R7.3 million. This increase is not supported by sufficient and appropriate documentation and as a result it was not possible to confirm that this amount was due to the municipality and recorded at the correct amount.
5. The municipality could not provide evidence that the other debtors of R24.3 million disclosed in note 2 will be collected. As a result provision for the impairment of long term debtors disclosed in note 34 is understated by R18.6 million, other debtors

disclosed in the statement of financial position is overstated by R18.6 million and impairment losses disclosed in the statement of performance is understated the same amount.

Trade and other receivables

6. Chris Hani District Municipality as the Water Services Authority (WSA) appointed the local municipalities in the district as Water Services Providers (WSP). As per the service level agreements the local municipalities must collect the water services revenue and maintain the assets on behalf of the district municipality. All water revenue, expenses, assets and liabilities should be recorded in the books of the district municipality. The municipality did not account for any of the water transactions and balances. Due to poor record keeping by the relevant local municipalities, it was not possible, even after performing alternative procedures, to determine the amount by which trade receivables, revenue, expenditure, other assets and creditors are understated.

Property, plant and equipment (PPE)

7. Completed infrastructure assets and those under construction were expensed instead of being capitalised as required by GRAP 17. In addition, the fixed asset register used to support the amounts in the financial statements did not provide sufficient evidence to identify and trace assets from the floor to the register and vice versa. As a result property, plant and equipment including capital work-in-progress is understated by R143.2 million, expenditure is overstated by R77 million and accumulated surplus is understated by R65 million.

Provisions

8. In the audit report for the year ended 30 June 2008, I reported that the leave provision could not be verified. Management have not effected any adjustments to the balance as previously disclosed or provided evidence that the leave balances which formed the basis of the leave provision as previously disclosed were correct, and as a result, the corresponding figure for the leave provision of R4 million is still could not be verified.
9. Errors in the number of days leave due to employees at the beginning of the year were not corrected. As a result the closing leave balances which form the basis of the leave provision are not accurate or recorded at the correct amount. The lack of appropriate records prevented the quantification of this misstatement.

Creditors

10. The corresponding figure for creditors did not reconcile to the prior year audited financial statements as it increased by R9.3 million. This increase is not supported by sufficient and appropriate documentation and as a result it was not possible to confirm that this amount was owed by the municipality and recorded at the correct amount.
11. Management did not accrue for all retentions due to suppliers on its completed projects as a result the retentions payable on completed projects as disclosed in the statement of financial position and note 10 is understated by R8.7 million while expenditure is understated by the same amount.

Unspent conditional grants and receipts

12. In the audit report for the year ended 30 June 2008, I reported that the balance of unspent grants was adjusted by journal entries totaling R18 million that were not supported by adequate and appropriate supporting documentation and for which no evidence of council approval was provided. Management have not effected any adjustments to the corresponding figures as previously disclosed, and as a result, the corresponding figure for unspent grants is understated and corresponding figure for accumulated surplus is overstated by R18 million.
13. Unspent conditional grants and receipts of R128.1 million disclosed in the statement of financial position does not reconcile to the amount of R119 million disclosed in note 20. No documentations or explanation has been supplied for the difference of R9.1 million.

Accumulated surplus

14. In the audit report for the year ended 30 June 2008, I reported that accumulated surplus was adjusted by journal entries totalling R24.2 million without adequate and appropriate supporting documentation. No adjustments have been processed or documentation provided to confirm that these journals were appropriate. As a result it was not possible to verify that the accumulated surplus at the end of the year under review and the corresponding figure contained all appropriate entries, was accurate and recorded at the correct amount.
15. The corresponding figure of the accumulated surplus does not reconcile to the prior year audited financial statements and decreased by R4.8 million. This decrease is not supported by sufficient and appropriate supporting documentation. As a result it was not possible to confirm that the corresponding figure for the accumulated surplus was recorded at the correct amount.

Employee related costs

16. The salaries paid to employees who are employed on the roads projects are deducted from employee costs and included in project expenditure. As the employees are full time employees of the municipality and not employed on the project, employee costs are understated and project expenditure is overstated by R5.5 million.

Irregular expenditure

17. Irregular expenditure of R76.8 million is not disclosed in the financial statements. This irregular expenditure was a result of non – compliance with the supply chain management policy and irregular salary payments.

Financial instruments

18. The municipality did not comply with the provisions of the International Accounting Standards (IAS) 32 and 39 in respect of the disclosure, recognition and measurement of financial instruments. All applicable disclosures of IFRS 7 have not been made. Due to a lack of documentation it was not possible to assess the impact of this non-disclosure on the financial statements.

Unauthorised expenditure

19. Unauthorised expenditure of R3.8 million relating to overspending of a main division of the budget and expenditure that was not in accordance with the objective of the

main division of the budget was omitted from the amount of R23 million unauthorised expenditure disclosed in note 37.1 to the financial statements.

Fruitless and wasteful expenditure

20. Fruitless and wasteful expenditure of R1.7 million relating to penalties and interest on incorrect VAT claims submitted to the South African Revenue Services was omitted from the amount disclosed in note 37.1 to the financial statements.

Disclaimer of opinion

21. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Unaudited supplementary schedules

22. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Non-compliance with applicable legislation

MFMA

23. Contrary to section 69 of the MFMA the draft service delivery and budget implementation plan and drafts of the annual performance agreements for all senior managers was not presented to the mayor within 14 days after approval of the annual budget.
24. Unauthorised expenditure of R8,1 million from the 2007-08 financial year as well as an amount of R350 866 that was transferred to the statement of financial performance in that year has not been condoned, and authorised in an adjustment budget or certified by council as required by section 32 of the MFMA.
25. The municipality did not submit electronic or signed returns on their conditional grants spending for the year as required by section 71 of the MFMA.
26. The mayor did not submit to council the quarterly reports by budge and finance within the specified period as required by section 52 of the MFMA.
27. Contrary to section 11 of the MFMA the accounting officer did not table in council and submit to Treasury and to the Auditor-General a consolidated report of all withdrawals made in terms of subsection 1 (b) to (j) within 30 days of the end of each quarter.

28. Contrary to section 127 of the MFMA the 2008 annual report was not submitted to the Auditor-General after it was tabled in council.

Municipal Systems Act (MSA)

29. Contrary to section 19 of the MSA no evidence was provided that the municipal manager gave notice to the public determining time, date and venue of every ordinary meeting of the council and special or urgent meetings of the council.

Governance framework

30. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

31. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
4-5	Other debtors			5		1
6	Trade and other receivables – water transactions not disclosed	5				
7	Property, plant and equipment – understated	5				1
8-9	Provisions			3		
10-11	Creditors			5,3		
12-13	Unspent conditional grants and receipts			5		1
14-15	Accumulated surplus			5		
16	Employee costs – salaries misallocated	5				
17	Irregular expenditure – SCM and salaries	5		3,4		1
18	Financial instruments – inadequate disclosure	1				
19	Unauthorised expenditure understated	5		3		
20	Fruitless and wasteful expenditure not disclosed					1

Control environment

32. Management did not establish and maintain an environment throughout the municipality that was supportive of internal control and conscientious management. The failure to create a stable control environment through the adoption of approved policy and procedure frameworks contributed largely towards the same matters that were reported in the previous financial year, being reported on again. Furthermore there was a lack of review and reconciliations to ensure competent and error free reporting.
33. The non-submission of documentation and information was continuously brought to the attention of management but did not receive appropriate attention.

Control activities

34. Manual or automated controls were often not found in the municipality's systems. These deficiencies were also not addressed even though they often have been raised in prior audit reports. Policy and procedures frameworks have not been created and implemented for all major accounting cycles.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
CA = Control activities	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7

Key governance responsibilities

35. MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
	Clear trail of supporting documentation that is easily available and provided in a timely manner		

No.	Matter	Y	N
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		✓
Quality of financial statements and related management information			
2.	The financial statements were not subject to any material amendments resulting from the audit.		✓
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.		✓
Timeliness of financial statements and management information			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines section 126 of the MFMA.	✓	
Availability of key officials during audit			
5.	Key officials were available throughout the audit process.		✓

Development and compliance with risk management, effective internal control and governance practices		
6.	Audit committee	
	<ul style="list-style-type: none"> • The municipality had an audit committee in operation throughout the financial year. • The audit committee operates in accordance with approved, written terms of reference. • The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. 	✓
7.	Internal audit	
	<ul style="list-style-type: none"> • The municipality had an internal audit function in operation throughout the financial year. • The internal audit function operates in terms of an approved internal audit plan. • The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA. 	✓
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.	✓
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.	✓
10.	The information systems were appropriate to facilitate the preparation of the financial statements.	✓
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set	✓

	out in section 62(c)(i) of the MFMA.		
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	✓	
Follow-up of audit findings			
13.	The prior year audit findings have been substantially addressed.	✓	
14.	Oversight resolutions have been substantially implemented.	N/A	
Issues relating to the reporting of performance information			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.	✓	
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.	✓	
17.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the municipality against its mandate, predetermined objectives, outputs, indicators and targets section 68/87 of the MFMA.	✓	
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	✓	

36. The control environment in the municipality is not conducive to sound governance and accountability as the leadership has not ensured that the control environment has received the appropriate attention. The following key governance responsibilities have not been effectively addressed:

- Not all information was presented for audit purposes and management also did not present a copy of the annual report prior to the issue of the audit report. Senior management was also not always available to respond to audit queries.
- There is a lack of monitoring over financial accounting processes. This resulted in material amendments to the financial statements. Financial accounting processes have not been assessed and adjusted to ensure that all processes support the information requirements of the GRAP framework.
- Although the municipality has a risk committee, it was not functional in the 2008-09 financial year. The municipality also did not have a disaster recovery plan in place for the year.
- The internal audit department did not submit quarterly reports to the audit committee to follow up on previously reported audit findings.
- Out of the ten internal audits planned for the year in terms of the internal audit annual plan, only two were carried out. In addition, no audits of performance information were carried out.
- The significant deficiencies in the design and implementation of internal control in respect of the financial, risk assessment and compliance with

applicable laws and regulations areas were attributed to a lack of implemented controls and a lack of monitoring and supervision by management.

- A risk assessment process was last undertaken in the 2008 financial year
- As is evident from the findings in this report the accounting record system of the municipality was not in all respects adequate to allow for the preparation of the annual financial statements.
- Management has not taken sufficient action to clear all prior year audit findings. There was no audit intervention plan and certain matters in the management report as well as this report were also raised in prior financial years.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

37. I have reviewed the performance information as set out on pages xx to xx.

The accounting officer's responsibility for the performance information

38. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

The Auditor-General's responsibility

39. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
40. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.
41. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Non-compliance with regulatory requirements

Lack of reporting on all predetermined objectives in annual report

42. The municipality has not reported on all the predetermined objectives in accordance with the prescribed format, as required by section 46 of the Municipal Systems Act.
43. The performance report does not include comparison with the performance in the previous year, indication of measures taken to improve performance and the performance of each external service provider throughout the year,

Lack of effective, efficient and transparent systems and internal controls regarding performance management

44. There is no person ultimately responsible for the co-ordination and managing of the reporting on progress against the pre-determined objectives. In addition, the roles, responsibilities and accountabilities for developing and evaluating output measures, collecting and compiling performance information, ensuring data integrity, monitoring and measuring data integrity and reporting the information are not clearly documented and communicated to all staff members.

Content of integrated development plan (IDP)

45. The integrated development plan of the Chris Hani District Municipality did not include the key performance indicators and performance targets determined in terms of its performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001.

Internal auditing of performance measurements

46. The municipality did not develop and implement mechanisms, systems and processes for the auditing the results of performance measurement as part of its internal audit processes and thus contravened section 45 of the MSA.

Usefulness and reliability of reported performance information

47. The following criteria were used to assess the usefulness and reliability of the information on the municipality's performance with respect to the objectives in its integrated development plan:

- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan?
- Relevance: Is the performance information as reflected in the indicators and targets clearly linked to the predetermined objectives and mandate. Is this specific and measurable, and is the time period or deadline for delivery specified?
- Reliability: Can the reported performance information be traced back to the source data or documentation and is the reported performance information accurate and complete in relation to the source data or documentation?

The following audit findings relate to the above criteria:

Inconsistently reported performance information

48. The following objectives recorded in the quarterly performance reports are not recorded in the IDP:

- Ensure that hawkers comply with minimum standards
- Implementation of training identified in the WSP
- Implement keys to food safety training
- Implement Health and Safety Programme

49. The following objectives recorded in the quarterly performance reports were not

budgeted for in the SDBIP:

- Implementation of Food safety
- Implement Keys to food safety training
- Implement NSF project
- Implement Health and Safety Programme
- Develop a sustainable brand for the institution

50. The IDP does not include a measurable target in respect of Nguni bulls to be purchased during the year and as a result the key deliverable could not be verified against the intended target. In addition, as per the SDBIP R1 million was allocated for this objective, but as per the annual performance report R5,2 million was budgeted. The actual expenditure was R5,1 million.

APPRECIATION

51. The assistance rendered by the staff of Chris Hani District Municipality during the audit is sincerely appreciated.

Auditor-General

East London

29 January 2010



Auditing to build public confidence